HOUSE BILL ANALYSIS
HB 1799

Title: An act relating to letters of credit under the uniform commercial code.

Brief Description: Regarding letters of credit under the uniform commercial code.

Sponsors: Representatives Sheahan, Appelwick, Costa and Sullivan; by request of Washington Uniform Legislation Commission.

HOUSE COMMITTEE ON LAW & JUSTICE

Staff: Bill Perry (786-7123).

Background: Article 5 of the Uniform Commercial Code (UCC) deals with letters of credit. A letter of credit is a promise, or authorization, to honor a demand for payment. The letter of credit may be issued to a customer of a bank, for instance, and contain conditions upon which the bank promises to honor a demand for payment. An applicant– applies to an issuer– for a letter of credit that may then be used by a beneficiary– who may or may not be the applicant. Upon completion of the conditions of the letter of credit, the beneficiary presents– the letter to the issuer for honoring.–

Letters of credit are generally used to facilitate the purchase and sale of goods, often internationally, by assuring the seller of prompt payment without having to rely on the solvency and good faith of the buyer. In order to be paid, the seller must meet the conditions of the letter, for instance, by presenting to the issuer of the letter the bill of sale for goods sold to the holder of the letter.

It has been estimated that almost $500 billion worth of letters of credit is issued annually, about half of which is issued in this country. The original UCC article on letters of credit was drafted in the 1950s. Washington adopted Article 5 of the UCC in 1965. None of Washington’s provisions has been amended since.

In recent years many developments have occurred in the use of letters of credit. Particularly, the use of modern electronic methods of communication has changed the way business is done. Much of the use of letters of credit is now done under what have become customary rules of practice. Many of these rules are part of the Uniform Customs and Practice for Documentary Credits (UCP). In part because the original Article 5 predates most of these modern developments, a growing number of disputes over the use of letters of credit end up in court.

The National Conference of Commissioners on Uniform State Laws periodically reviews the UCC and proposes updates. In 1995, the commission proposed the latest rewrite of Article 5 of the UCC. So far, at least 14 states have adopted this 1995 version.

Summary of Bill: The 1995 version of Article 5 of the UCC is adopted. The law on letters of credit is substantially rewritten.

It is made explicit that the rights and obligations of parties to a letter of credit are independent of rights and obligations of parties to any underlying transaction, contract, or arrangement that gave rise to the letter of credit.

Electronic methods of creating records related to letters of credit are specifically authorized. Express authorization and procedures are also provided for the use of a wide variety of modern business practices, including the use of deferred payment letters, two- party letters, and perpetual letters.

Consequential and punitive damage awards against issuers of letters of credit are prohibited, but actual and incidental damages and reasonable expenses and attorney's fees may be recovered for wrongly dishonoring a letter of credit.

A one-year statute of limitations is established for actions based on a wrongful dishonoring of a letter of credit. The statute runs from the date the letter expires, or the date the cause of action accrues, whichever is later.

The issuer of a letter of credit may pick the jurisdiction whose law will apply in the case of a lawsuit.

Parties are generally free to depart from the provisions of Article 5 and vary the terms of a letter of credit by agreement. The UCP or other rule of custom or practice may control issues of liability except with respect to certain provisions of Article 5. These provisions include: use of a letter of credit for personal, family or household purposes;– a requirement that a perpetual– letter expires in five years; rules covering assignment of proceeds and subrogation rights; and the fact that rights under a letter are independent from rights under an underlying agreement.

A beneficiary of a letter of credit is held to warrant certain things. These warranties are: that there has been no fraud or forgery in the presentment of the letter; and that honoring the letter will not violate an agreement between the beneficiary and the applicant.

Unless otherwise expressly provided in the letter, a letter of credit is irrevocable.

Except for fraud, forgery, or expiration, an issuer cannot assert a discrepancy from standard practice as a reason to dishonor a letter, unless the issuer has given notice of the discrepancy to the beneficiary within seven days of presentation of the letter.

Fiscal Note: Not requested.

Effective Date: Ninety days after adjournment of session in which bill is passed.

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